Rev. Rul. 56-185, 1956-1 C.B. 202, **modified Rev. Rul. 69-545, 1969-2 C.B.117**

Criteria or tests to be met in determining whether a hospital qualifies for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(3) thereof.

Advice has been requested concerning the criteria or tests to be met in determining whether a hospital can qualify for exemption from income tax as a public charitable organization.

Section 501(c) of the Internal Revenue Code of 1954 describes certain organizations exempt from income tax under section 501(a) and reads, in part, as follows:

> (3) Corporations, and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific * * * purposes, * * * and no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

The only ground upon which a hospital may be held to be exempt under section 501(c)(3) of the Code is that it is organized and operated primarily for educational, scientific or public charitable purposes. Usually, the ground for exemption is that it is organized and operated for public charitable purposes. The Supreme Court of the United States in Helvering v. Susan D. Bliss et al., 293 U.S. 144, Ct. D. 884, C.B. XIII-2, 191 (1934), held that the provisions of law granting exemption of income devoted to charity are liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed. Thus, in regard to hospitals and similar organizations, the Internal Revenue Service takes the position that the term 'charitable' in its legal sense and as it is used in section 501(c)(3) of the Code contemplates an implied public trust constituted for some public benefit, the income or beneficial interest of which may not inure to the benefit of any private shareholder or individual.

In order for a hospital to establish that it is exempt as a public charitable organization within the contemplation of section 501(c)(3), it must, among other things, show that it meets the following general requirements:

> 1. It must be organized as a nonprofit charitable organization for the purpose of operating a hospital for the care of the sick. A nonprofit hospital chartered only in general terms as a charitable corporation can meet the test as being organized exclusively for charitable purposes. See

Commissioner v. Battle Creek, Inc. 126 Fed. (2d) 405.

2. It must be operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay. It is normal for hospitals to charge those able to pay for services rendered in order to meet the operating expenses of the institution, without denying medical care or treatment to others unable to pay. The fact that its charity record is relatively low is not conclusive that a hospital is not operated for charitable purposes to the full extent of its financial ability. It may furnish services at reduced rates which are below cost, and thereby render charity in that manner. It may also set aside earnings which it uses for improvements and additions to hospital facilities. It must not, however, refuse to accept patients in need of hospital care who cannot pay for such services. Furthermore, if it operates with the expectation of full payment from all those to whom it renders services, it does not dispense charity merely because some of its patients fail to pay for the services rendered.

3. It must not restrict the use of its facilities to a particular group of physicians and surgeons, such as a medical partnership or association, to the exclusion of all other qualified doctors. Such limitation on the use of hospital facilities is inconsistent with the public service concept inherent in section 501(c)(3) and the prohibition against the inurement of benefits to private shareholders or individuals. It is recognized, however, that in the operation of a hospital there must of necessity be some discretionary authority in the management to approve the qualifications of those applying for the use of the medical facilities. The size and nature of facilities may also make it necessary to impose limitations on the extent to which they may be made available to all reputable and competent physicians in the area.

4. Its net earnings must not inure directly or indirectly to the benefit of any private shareholder or individual. This includes the use by or benefit to its members of its earnings by way of a distribution of profits, the payment of excessive rents or excessive salaries, or the use of its facilities to serve their private interests. If provision is made in the bylaws for dividends, exemption will not be allowed even though no dividends have been declared. Exemption will not be defeated, however, merely because the shareholders or members might possibly at some future date share in the assets upon dissolution in the absence of a case of mala fides where there appears to be a plan on the part of the shareholder or individual to acquire assets on the dissolution of the corporation.

A community hospital of the type supported partly by

contributions from the general public and/or public grants from a city, county or state, normally meets the requirements of section 501(c)(3) as a public charitable organization. It is formed for the purpose of furnishing hospital facilities to all persons in the community at the lowest possible cost and necessarily accepts patients who are unable to pay for hospital facilities in order to retain the support of the community. A nominal charity record for a given period of time, in the absence of charitable demands of the community, will not affect its right to continued exemption. On the other hand, a hospital formed by one or more physicians in a community who may own the capital stock thereof or rent the hospital facilities to a corporation which they control requires careful study to determine whether it is being operated in part to serve their interest, directly or indirectly. See I.T. 2421, C.B. VII-2, 150 (1928).

A hospital formed to operate on a membership basis to provide, at fixed rates, prepaid hospitalization to its members is not a charitable organization within the meaning of section 501(c)(3) of the Code. Compare G.C.M. 22554, C.B. 1941-1, 243. But exemption will not be denied merely because the hospital maintains a prepayment plan, so long as such plan is available to all persons living in the area and so long as the hospital makes available its facilities to the indigent as well as to pay patients to the same extent as any other hospital not operated for profit.

A hospital which is organized as required by section 501(c)(3) of the Code, but which engages primarily in operations foreign to its stated purposes, cannot qualify as a charitable organization under that section. Conversely, a hospital, otherwise exempt, will not lose its exempt status by reason of engaging in operations unrelated to its states purposes if such operations may be considered as merely incidental. Such a hospital will, however, be required to file an income tax return, Form 990-T, U.S. Exempt Organization Business Income Tax Return, if its gross income (included in computing unrelated business taxable income) for the taxable year is $1,000 or more.